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Economic Outlook 1980

California Report



October 1979

Bank of America forecasts modest growth for the California economy in 1980—in contrast to the U.S. economy where serious problems are anticipated. Growth in 1980 will be much slower than in 1978 and 1979, but California will continue to outperform the nation in most categories. Record levels of employment, personal income, retail sales, business revenue, and gross farm income should be reached in 1980.

Inflation remains the principal economic problem. Led by energy cost increases, inflation is expected to increase at near double-digit rates in 1980. The average rise in California consumer prices will exceed 11 percent in 1979 and remain near 10 percent in 1980.

Smaller real gains in consumer spending and some hesitation in business investment will slow growth in the California economy. Consumer and business confidence both are restrained by anxieties about inflation and by uncertainties about national, state, and local programs and policies in energy, taxes, housing, construction, and international trade.

In the 1980s, California may experience slower economic growth than in the past decade. The long-term growth and stability of the California economy depends upon the success of efforts to balance labor force growth with the creation of new jobs and to reduce the impact of inflation on personal income growth. California's future economic health will also depend upon a positive business climate so that corporate leaders and investors—in the U.S. and abroad—will perceive California as a hospitable environment for the establishment and expansion of facilities.

FORECAST HIGHLIGHTS

- Personal income is expected to rise to \$247 billion—representing a current-dollar gain of 11.5 percent or an inflation-adjusted real gain of 1 to 2 percent. In 1980, personal income growth will lag behind the 13.9 percent and 12.5 percent gains of 1978 and 1979, respectively. (See Figure 1.)

- Consumer prices, led by higher energy costs, are expected to increase by about 10 percent in 1980. While this is a slightly slower rate than projected for 1979, inflation will still remain high by historical standards.

- More than 200,000 new jobs will be created in 1980, following the gain of 300,000 jobs in 1979. However, the increase of jobs in the state will not keep pace with growth in the total labor force. As a result, the unemployment rate, which dropped dramatically from more than 9 percent in 1976 to approximately 6.5 percent in 1979, will rise to approximately 7.7 percent in 1980.

- Retail store sales volume will rise 12 to 14 percent, reaching approximately \$111 billion in 1980. However, inflation will be responsible for over three-fourths of this increase, and real sales volume will not increase substantially. The weakest retail sales areas will be in consumer-oriented durable goods, particularly automobiles.

- Housing and residential construction dollar volume will continue to show modest growth in 1980. Unit volume is expected to remain at about the 1979 level of 200,000 housing starts. While this is below the 229,000 units constructed in 1978, it will represent an average year, historically, for the construction industry. In contrast to previous eco-

nomic slowdowns, the building industry will not suffer a significant decline.

- California's international trade volume will continue to show solid growth with a 12 percent increase expected. Total trade volume will approach \$48 billion with both imports and exports showing strong gains. Exports will grow more rapidly, to \$21.6 billion, but still trail imports of \$26.0 billion in 1980.

- California gross farm income is expected to increase to \$12.6 billion, a 7.7 percent gain over the \$11.7 billion forecast for 1979. Net farm income is expected to remain level in 1980 at \$3.1 billion.

- Recent oil price increases are slowing growth and increasing inflation. The outlook is for further price increases in 1980 and the fuel component of the Wholesale Price Index is expected to increase about 27 percent next year. With Californians spending 8 to 10 percent of their budgets on energy, consumers will have to change their spending and fuel usage patterns.

- California business is expected to experience a 13 percent growth in sales in 1980—compared with a 16 percent gain in 1979. Net income will shrink even more than sales as profit margins are eroded by rising costs. However, California's unique industry structure will ensure that statewide industrial activity will generally outperform national trends.

- While the economic slowdown will affect all major regions of California, its impact on the fastest growing counties, such as San Diego, Orange, Santa Clara, and Sacramento, will be less noticeable.

Growth and Inflation: Few Real Gains

In contrast to the U.S. recessionary outlook, California is expected to suffer fewer economic problems than the nation in 1980. The California economy will continue to expand, but at a slow rate. Real economic growth in the state will increase about 2 percent in 1980, compared with a 2.5 percent growth in 1979. In contrast, the U.S. economy is expected to grow 0.4 percent in 1980 and 1.3 percent in 1979.

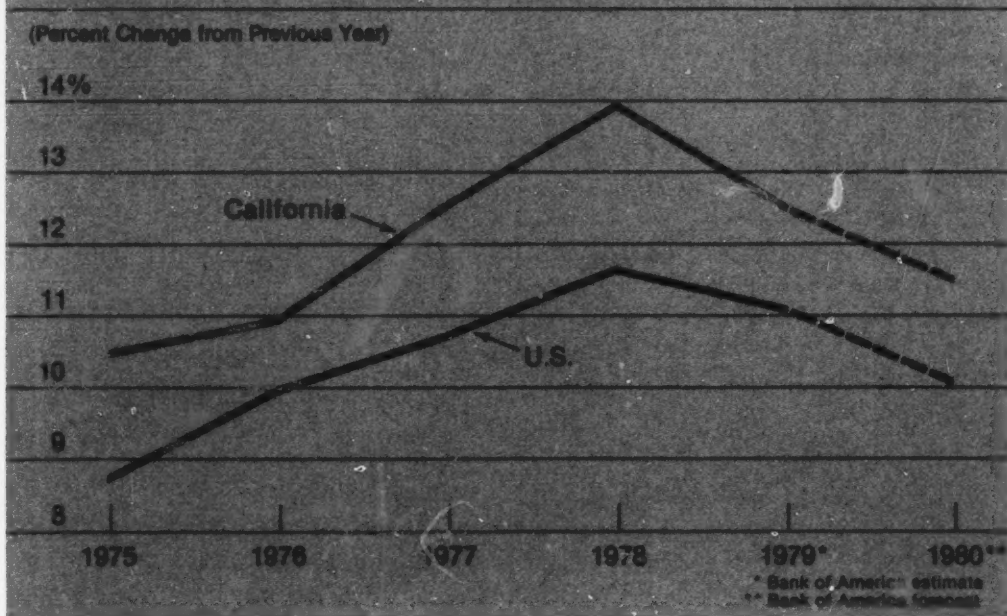
California's slower growth will continue to exceed that of the nation as a whole because of basic differences in the U.S. and California economies. The U.S. economic recession is being led by a reduced demand for consumer-oriented manufactured goods. Industries that are most adversely affected by reduced consumption of durable goods do not represent a substantial portion of California's manufacturing and industrial base.

Manufacturing industries of major importance in California, particularly electronics and aerospace, will experience continuing strong demand for their products through 1980. Employment in these industries will continue to increase, contributing to growth in the economy.

Furthermore, industries providing various types of services to individuals and businesses—California's second largest employment group—are a more important part of the California economy than that of the nation. Because the demand for services in a slowing economy fluctuates less than the demand for durable and non durable goods, California's service sector should remain stable and soften the effects of the U.S. recession in the state.

Despite slowing economic growth, inflation will continue to be the major problem in California. The state's Consumer Price Index is expected to increase over 11 percent in 1979 and about 10 percent in 1980. The state's more rapid economic growth com-

**FIG. 1 PERSONAL INCOME GROWTH RATE
CALIFORNIA AND U.S. 1975-1980 (Current Dollar Basis)**



pared to that of the nation and a population growth rate twice that of the U.S. have created demand-pull price pressures that are stronger in California than in other regions of the country.

Consumer price increases have been concentrated in housing, energy, and medical care. The rate of price increases for these necessities will continue to exceed the overall inflation rate in 1980.

Food prices have also increased sharply. At the farm level, this is largely due to weather and labor-related causes, as well as a cyclical reduction in beef supplies. The cost of delivering food to consumers also has contributed to inflation, as transportation, packaging, and retailing costs have escalated rapidly.

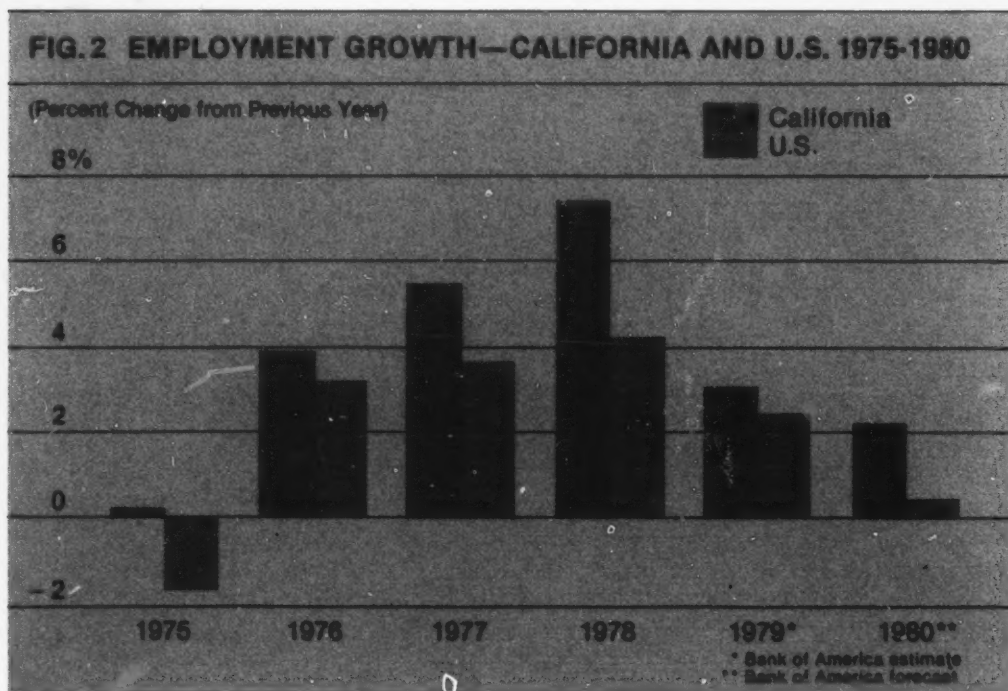
With a slowing economy and continuing high inflation, real personal income will rise only modestly in 1980. Nonetheless, the rate of growth in real personal income will exceed that of the U.S. This growth will largely be the result of greater total employment.

Employment: Fewer New Jobs

California employment should continue to expand in 1980—reaching 10.4 million jobs—up 2.1 percent from 1979. (See Figure 2.) All employment sectors except state and local government are expected to grow. An uncertain factor in the employment outlook is the possibility of strikes and work slowdowns caused by inflationary pressure on wages.

Manufacturing employment, led by aerospace and electronics, is expected to increase by approximately 75,000 jobs or 4 percent in 1979. In 1980, manufacturing is expected to increase by 70,000 jobs or about 3.5 percent. Aerospace employment will continue to be stimulated by the increase in commercial and military aircraft orders from the U.S. and abroad.

The service sector is expected to increase by 55,000 to 65,000 jobs in 1980. This is approximately equal to the number of jobs created in this sector in 1979. In retail trade, the



largest employment sector, 75,000 jobs will be created in 1979, followed by 60,000 to 70,000 jobs in 1980, as the rate of increase in retail sales slows in real terms.

Total employment in the construction industry is expected to remain level in 1979 and 1980. This represents a substantial slowing of the strong job growth in this sector in 1977 and 1978.

State and local government, traditionally one of California's largest employers, will not expand employment in 1980. In the aftermath of Proposition 13, employment in this sector will decline about 1 percent, mostly due to attrition.

Unemployment in California is expected to increase to about 7.7 percent in 1980 as the state's labor force expands faster than job creation. While 210,000 new jobs are expected in California in 1980, the labor force will increase by about 285,000 people. This 2.6 percent growth in the state's labor force is substantially higher than the projected U.S. labor force growth of 1.4 percent. The rapid growth of California's labor force is expected to continue as net immigration totals more than 175,000 people annually and the number of women employed outside the home continues to increase.

Consumer Expenditures: Declining Purchasing Power

Consumer spending, measured by retail store sales volume, is expected to increase to \$111 billion in 1980, up approximately 12 to 14 percent from 1979. However, this increase will be primarily due to rising prices. Thus, real consumer expenditures will show little increase. The slowdown in consumer spending will reduce demand and production of goods and services, reduce business investment, and inhibit the creation of new jobs in the state.

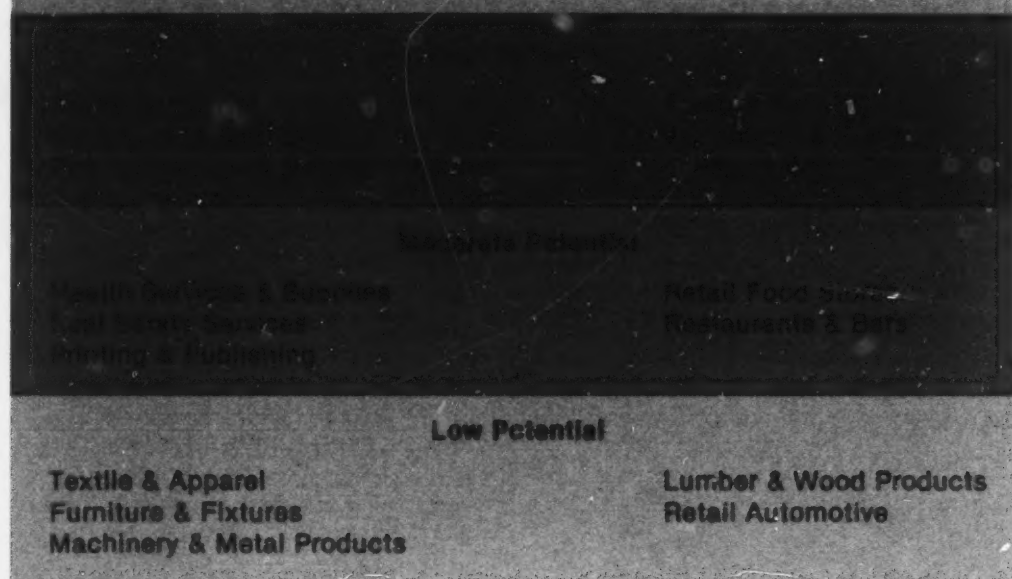
Consumer expenditures may be divided into two major categories: committed expenses, which includes necessities and taxes, and uncommitted expenses. The bulk of household expenditures occur in the necessities category which includes food, shelter, and transportation. Historically, people have been willing to spend an increasing share of their incomes on necessities to maintain a constant living standard. Consequently, the percentage of income spent on uncommitted expenses has declined and will continue to decline as prices for necessities increase faster than inflation.

The average California household income has more than doubled since 1970—from \$13,000 in 1970 to an estimated \$27,400 in 1980. Despite this, the percentage of household income devoted to committed expenses or necessities has increased. In 1980, approximately 63 percent of the average household income will be spent on necessities or committed expenses—compared with 59 percent of income in 1970. This means the percentage of household income available for uncommitted expenses—including savings—will have dropped from 41 percent to 37 percent.

The economic impact of changing consumer spending patterns in California will be important for business and the consumer. Many people—with less uncommitted funds to spend—will take fewer trips, postpone the purchase of durable goods, and generally cut unnecessary expenses. This reduced consumer spending will contribute to the overall economic slowdown.

Thus, businesses and communities which depend upon income derived from consumers' uncommitted funds will find 1980 more difficult. Businesses in resort areas and those located along highways may be expected to suffer some revenue losses from reduced sales.

**FIG. 3 CALIFORNIA INDUSTRIES
PROJECTED INCOME GAINS IN 1980**



Business Outlook:

Slowing Income and Sales Gains

California business is expected to experience a 13 percent growth in sales volume in 1980, compared with a 16 percent gain in 1979. Net income will be adversely affected as profit margins shrink due to rising costs and lagging sales. Aggregate net income gains of about 10 percent before taxes are expected in 1980, significantly below the 17.4 percent increase expected for 1979. Even so, California's unique industry structure will ensure that industrial activity statewide will generally outperform national trends. In the U.S., for example, profits before taxes are expected to increase only 3 percent in 1980.

Capital spending programs of business will be significantly affected by the economic slowdown. While many industries have continued to spend for plant, equipment, and inventories in the first half of

1979—primarily due to the high opportunity cost of waiting in inflationary times—this spending will moderate in 1980.

The California industries with the highest income potential (see Figure 3) all have unique strengths which should minimize the impact of the recession. Higher energy prices and increased exploration programs will provide further growth in the oil and energy services industry. Aerospace manufacturing will also be aided by higher energy prices, which have increased the obsolescence of the current worldwide aircraft fleet. Pharmaceuticals and related products, agriculture, and food processing should be relatively unaffected by the recession. Electronics and high technology manufacturers will see further growth in commercial and industrial product sales and in government-related purchases, offsetting any weaknesses that they may face in the consumer areas. Inventory-to-sales ratios for electronic parts and equipment manufac-

turers are now in much better shape than during the 1974-75 period. This will help to ensure a stronger outlook for that industry.

The high income potential industries will be critically important to the overall economic outlook for California. These industries provide nearly 50 percent of the total manufacturing jobs in the state. Growth in these industries will help soften the deteriorating economic conditions for business in general in 1980.

Oil Price Increases: Undermining Real Growth

The recent OPEC oil price increases and the worldwide energy supply shortfall have serious implications for California. OPEC actions reemphasize our dependence on energy for economic growth. Increasing energy and fuel costs will force Californians to make adjustments in their lifestyles.

Over the next two years, energy price increases will have four major impacts on the California economy:

- Slower real growth and higher inflation
- Slower employment growth
- Shifts in consumer spending patterns
- Impacts on business, including transportation interruptions, higher fuel and energy costs, and production delays.

Fuel price increases, coupled with higher food and housing costs, will push consumer prices higher and slow real growth. The California Consumer Price Index in 1980 is expected to increase an extra one-half to one percent as a direct result of the OPEC oil price increases. Higher inflation will slow economic growth, leading to declines in the rate of employment growth. We expect employment growth to slow by 20,000 to 30,000 jobs because of higher energy prices.

Higher petroleum prices and fuel shortage concerns are causing consumers to reassess spending plans. With 8 to 10 percent of the consumer's budget now spent on energy, Californians will reduce their demand for other goods and services as fuel prices rise. Further, gasoline price increases and shortage fears are forcing people to concentrate shopping trips on weekends and to reduce their trips to distant recreation areas of the state. Meanwhile, the demand for public transit has increased.

Fuel price increases and energy shortages will also impact business—resulting in transportation interruptions, higher operating costs, and production delays. However, California industries are less energy intensive than industries in other regions of the country and, consequently, will be less adversely affected. Further, California industry has become more energy efficient in the past 10 years.

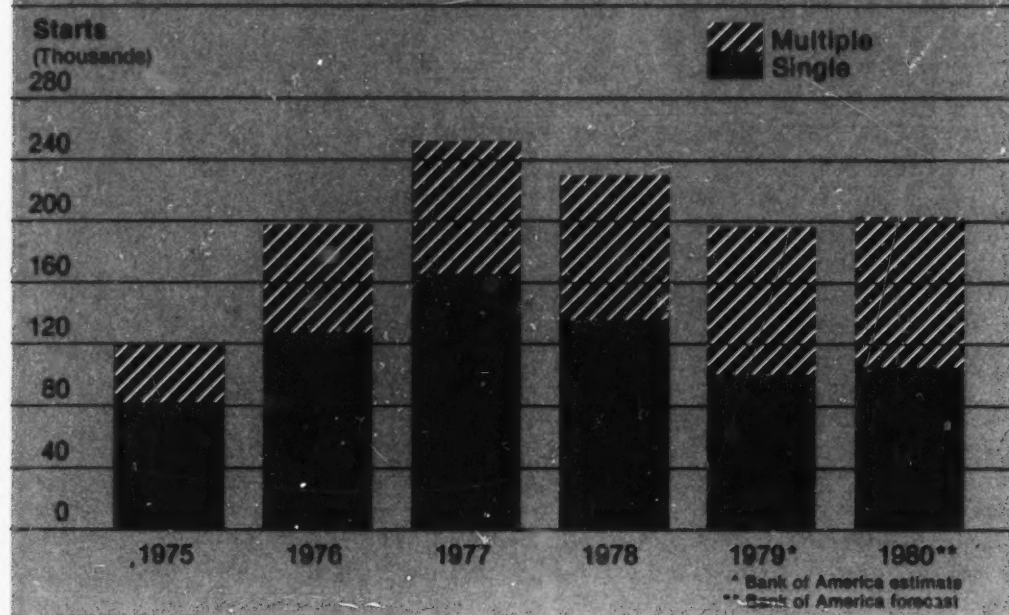
A further OPEC price increase of 10 percent, expected January 1980, means that we can expect the wholesale price of fuel to rise about 27 percent next year. This increase will push gasoline and diesel prices five to eight cents per gallon higher.

One positive impact is increased production of heavy crude oil reserves in central California. In light of higher prices and less government regulation, these reserves—estimated to be 10 billion barrels—will provide an additional domestic crude oil source.

Construction and Housing: Unlike Previous Slowdowns

In 1980, approximately 200,000 homes will be built in California. This number of units is close to the expected 1979 level of construction. Similarly, new home construction has averaged 200,000 over the past

FIG. 4 CALIFORNIA HOUSING STARTS 1975-1980



ten years. (See Figure 4.) In sharp contrast to previous slowdowns, 1980 will be a fairly good year for the building industry.

The homebuilding industry has thrived because of a strong demand generated by increased household formation rates, continued rapid immigration, strong employment gains, and rising household income. Further, many homeowners have found California homes to be great investments.

However, at expected market prices, there will be many potential buyers who cannot find a home they can afford. The purchasing group most seriously affected will be first-time home buyers. Affordable housing is becoming a major social concern, as well as an economic problem, as prices continue to rise faster than income gains.

Price increases will be especially large on lower or medium-priced homes, where the supply is very limited. Higher-priced homes will be more readily available. The 1980 outlook for the California housing in-

dustry is for increasing demand by first-time buyers and rollover purchasers, despite higher home prices and building costs. Investors-speculators will continue to purchase real estate, but less actively than in the recent past due to the high negative cash flow involved. In 1980, home prices are expected to increase by about 10 to 15 percent.

Increasing home prices, combined with higher operating and maintenance costs, are expected to result in an increased demand for smaller homes on less land. Consequently, we expect the construction of more multi-unit dwellings, condominiums, and duplexes and fewer single-family unattached dwellings.

Agriculture: A Good Year Ahead

California's gross farm income is expected to increase to \$12.6 billion in 1980, a 7.7 percent gain over the \$11.7 billion estimated for 1979. While cattle price increases were substantial in 1978 and 1979, they

will stabilize in 1980. Crop prices, particularly grains, will rise more dramatically in 1980 and continue the upward pressure on livestock producer feed costs and consumer food prices.

Net farm income is expected to remain at about \$3.1 billion in 1980, with production cost increases offsetting the gain in gross farm income. Production expenses will increase more rapidly than farm income in 1980 as the result of higher energy, feed, labor, equipment, and purchased beef and dairy cow replacement costs.

Cash receipts from livestock and livestock products are expected to increase about 8 percent in 1980, after a 14.4 percent increase in 1979. Milk sales will rise as a consequence of expanding production and higher prices. While rising feed costs will narrow operating margins, herd expansion will keep cow replacement prices near their recent high levels. Rising feed costs will also tend to dampen the expansion of the livestock sector, thereby prolonging high meat prices.

Cash crop proceeds are expected to increase nearly 7 percent in 1980, primarily due to higher field crop and fruit and nut crop sales. Because of the reduced 1979 grain harvests in the U.S.S.R. and Western Europe, significant grain price increases are anticipated in 1980 and grain acreage in California will increase.

Despite the record cotton crop expected in 1980 and a slowing economy, cotton prices will not decline significantly. Rising oil prices will help make cotton textiles more competitive against oil-based synthetic fibers.

Grapes and tree crops will also contribute to the increase in cash receipts. Favorable grape and tree crop prices in recent years have encouraged both orchard and vineyard expansion and production increases will offset most price declines. Dried

fruit and nut prices are expected to decline as supplies increase after being depleted in 1979. Producer prices for canning fruit will not increase significantly over 1979. This will result from inventory accumulation and narrow processor margins, caused by rising processing and marketing costs.

The value of California farm real estate is expected to increase 15 to 20 percent in 1980, compared with a 23 percent increase expected in 1979. While rapidly rising land values benefit existing owners, farmers find it more difficult to buy land and expand acreage. Also, potential farmers find it very difficult to become established. California's net farm income—unlike that of the nation—has increased more rapidly than the average farmland values during the 1970s. This provides a more solid economic foundation for the value of California farmland.

International Trade: Exports Will Lead Expansion

One of California's major assets is its international trade. California is a major gateway between two of the fastest growing areas in the world—the Asia-Pacific Basin and the Western United States—and trade has expanded by 324 percent since 1970. By comparison, total U.S. trade has increased 279 percent during the same period.

In 1980, total trade is expected to reach nearly \$48 billion, an increase of 12 percent over 1979. Exports are expected to expand 15 percent to \$21.6 billion and imports to reach \$26.0 billion, an increase of 10 percent. The state's trade deficit will be reduced significantly from \$6.5 billion in 1978 to under \$5 billion in 1980.

California's aerospace, agriculture, and electronics industries will provide major export opportunities in

1980. Japan continues to be our state's major trading partner—representing about one-third of our total trade.

California is the largest producer of manufactured goods for export in the nation—totaling over \$8.1 billion or 10 percent of the manufactured exports of the U.S.—surpassing Michigan, Texas, and New York. The rate of growth in manufacturing goods sold for export has been rising three times faster than overall domestic production.

Employment related to international trade has also increased, with over 500,000 jobs directly related to California's exports. One out of every five jobs in agriculture depends upon international trade. The creation of trade-related jobs will help offset employment slowdowns in the remainder of the economy.

REGIONAL ANALYSIS

In contrast to previous years, the rate of economic growth in Southern California may not outpace growth rates in Northern or Central California. Each of these geographic areas has strengths which preclude a severe economic decline and weaknesses which deter rapid growth.

In the south, continued growth is expected in the service, trade, and aerospace manufacturing sectors of the economy. Orange, San Diego, Riverside, and San Bernardino Counties will experience economic and financial growth. The outlook for Los Angeles County is less certain. About 50 percent of all manufacturing jobs in the state are located in Los Angeles County and demand for consumer-oriented manufactured goods is expected to decline in 1979 and 1980. However, the rate of economic growth in Southern California will approximate the state average.

In the north, economic activity will also be mixed. The service and trade

sectors will grow very slowly as consumers reduce their rate of spending. Electronic, electrical equipment, and transportation manufacturing will increase as will food processing. Regionally, the most rapid growth is expected in Sacramento and Santa Clara Counties. The largest decline in economic activity is expected to occur in the North Coast region due to reduced recreation spending and reduced timber harvesting.

The Central Valley continues to emerge as a major growth area of the state. Fresno, Kern, and Stanislaus Counties are leading the region's economic and population growth.

South

Los Angeles County

The economic outlook for Los Angeles County is for modest growth. Industries producing consumer-oriented manufactured goods will be adversely impacted as demand for these goods slows through 1980. Offsetting this, however, will be growth in the county's aerospace industry. Over 25 percent of all manufacturing jobs are aerospace related and employment in this sector will increase. The service and trade sectors will expand modestly, while growth of recreation-based industries will be flat. In total, the employment outlook for the county is for very slow growth, with unemployment remaining near 7 percent.

Orange County

The economic prospects for Orange County in 1980 are bright. Increases are expected in employment and sales. Unemployment rates will remain well below the state average. The region's manufacturing base is dominated by industries related to aircraft, electronics, and transportation equipment. The region pos-

sesses fairly large service and trade sectors while employment in the government sector is well below the state average. Consequently, the decline in the government sector statewide will impact Orange County minimally.

Although moderate employment growth in the county will continue, the region will suffer from a slowdown in population growth and a slowing construction industry.

San Diego County

In 1980, San Diego County's employment will increase about 6 percent and the population will grow by over 3 percent. However, labor force gains will exceed job growth and unemployment will increase slightly, to approximately 6.5 percent. The largest employment gains will occur in the high technology industries. Small gains are expected in the trade and retail sales sectors, as new shopping centers are built to accommodate the increased population. Food processing and recreation-based industries are expected to hold their own.

Riverside-San Bernardino

The Riverside-San Bernardino economy is expected to remain stable. The region's economic growth will be above the state average, but several factors will keep the rate below that of recent years. First, a slowing of demand for consumer-oriented durable goods will affect a substantial portion of the region's manufacturing sector. Second, dollar volume and employment in the large recreation sector will remain at about the 1979 level. Third, there will be no employment growth in the region's large government sector. Offsetting these trends, however, is expected growth in the large trade and service sectors of this region, which serves as a prime bedroom community for people working in surrounding areas.

North

San Francisco-Oakland

The economy of the Bay Area, supported by Northern California's largest concentration of population and business activity, is expected to grow slowly in 1980. Employment is expected to increase slightly while unemployment will remain about 6.5 percent. Small employment gains in the service, trade, and finance sectors are expected, with modest declines in the manufacture of apparel and metal products. The area's recreation industry should hold up because of the high cost of travel abroad and the relative attractiveness of the area to foreign visitors—given the decline of the dollar's foreign exchange value.

Santa Clara County

The outlook for Santa Clara County is good. Employment growth is expected to remain well above the state average and the county's unemployment rate remains one of the lowest in California. Employment growth will occur primarily in two sectors—high technology industries and business services. The production of high technology equipment makes up about 70 percent of all durable manufacturing in the area. Strong demand for these products in the U.S. and abroad guarantees steady growth in these industries. Research and development services also are in high demand and, consequently, service sector employment will increase.

Due to the high cost and low availability of housing, population growth in the area is expected to slow, and a few firms are looking for areas in which to relocate. This is not expected to pose a serious problem to the county in 1980.

Sacramento County

In 1980, economic prospects for Sacramento County are good. The county will continue to prosper and unemployment should decline. Employment growth of around 4 percent is expected in 1980, with more than 325,000 people employed in the county. Growing sectors will include trade, service, public utilities, and transportation. Food processing, warehousing, and import-export related employment will also increase slightly. The government sector, the region's largest, will post small employment declines in 1980, largely due to attrition.

North Coast

The North Coast region will experience declines in two major industries. The lumber and wood products industry will suffer from regulations hindering the harvesting of timber areas and from a slowdown in construction nationwide. Tourism and recreation—a major employment sector—will also decline. Visitor-days spent in recreation areas are expected to drop sharply as rising fuel costs and fears of gas shortages keep vacationers away

from the area. Trade, services, and lumber-related employment will decline and the region's unemployment rate will increase.

Central California

The outlook for California's central valley is good, as the economies in this region become more diversified and well balanced. In 1980, the region will show gains in population, employment, and sales. Employment gains in the service, trade, light manufacturing, oil exploration, and construction sectors have stabilized unemployment rates in much of the region. The population of the area is growing faster than the state average, as land available for building is more plentiful and home prices are 25 percent below the statewide average.

The valley's agricultural industry is expected to post a good year in 1980 and, consequently, the region should prosper as well. Food processing, warehousing, and transportation firms will have a good year. Manufacturing accounts for only about 10 percent of the region's employment, and the downturn in demand for consumer-oriented goods will not seriously impact the region.

Bank of America NT&SA, founded in 1904 by A. P. Giannini, has over 1,000 branches in 500 California communities and more than 120 branches and representative offices overseas. As of June 30, 1979, the bank's consolidated assets were more than \$95 billion.

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